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No. 89-675

In the Supreme Court of the United States

OCTOBER TERM, 1989

AMBASE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals adequately explained its holding that petitioner is not entitled to a current income tax deduction for unpaid agents' commissions attributable to deferred insurance premium installments.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-12a) is reported at 875 F.2d 377. The opinion of the Tax Court (Pet. App. 13a-29a) is unofficially reported at 52 T.C.M. (CCH) 1422.

JURISDICTION

The judgment of the court of appeals (Pet. App. 31a-32a) was entered on May 11, 1989. A petition for rehearing was denied on July 27, 1989 (Pet. App. 33a-34a). The petition for a writ of certiorari was filed on October 24, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a property and casualty insurer. During and prior to the years in dispute, 1968, 1969, and 1970, it issued numerous policies known as "deferred premium installment insurance policies." Pet. App. 2a. These policies covered periods of more than a year, and the insured was permitted to pay premiums on an installment basis rather than paying in full at the inception of the policy. The policies were sold by independent insurance agents, who were entitled to commissions equal to a fixed percentage of the premiums paid on the policies they sold. The premiums were paid by the policy holders to the agents, who deducted their commissions and remitted the balance to petitioner. Pet. App. 3a, 14a-15a.

The policies were cancellable prospectively by either party, but nonpayment of premiums was not sufficient reason for petitioner to cancel a policy. Until a policy was cancelled, petitioner remained responsible for losses covered by the policy, and the policy holder remained obligated to pay the premiums. If a policy was cancelled, petitioner returned to the agent any portion of a premium unearned on the cancellation date, less the agent's commission applicable to that portion of the premium. The agent, who was not entitled to retain a commission on any portion of a premium attributable to a period after cancellation, then remitted to the policy holder the full amount of the premium unearned on the cancellation date. Pet. App. 3a-4a, 15a-16a.

Pursuant to state laws, petitioner filed with state regulatory authorities annual statements of financial condition on forms approved by the National Association of Insurance Commissioners (NAIC annual statements). Those statements were prepared ac-

cording to the so-called earned and incurred method of accounting, known in the insurance industry as the NAIC Statutory Method. Petitioner included in the "premiums-written" account the total amount of premiums due for policies written during the year, even though payment of some of the premiums was deferred to a later year. By the same token, petitioner included in the "expenses-incurred" account the total amount of commissions that would be payable to its agents if the policies remained in effect for their full terms. Pet. App. 4a, 14a, 16a.

As a property and casualty insurance company, petitioner's federal income tax liability is governed by Sections 831 and 832 of the Internal Revenue Code.[1] In computing its taxable income, petitioner used the NAIC statement as the starting point, but necessarily modified the figures in that statement to conform to the governing provisions of the Code. Section 832(a) of the Code defines "taxable income" of a property and casualty insurance company as "gross income" (as defined in Section 832(b)(1)) less the deductions allowed by Section 832(c). Under Section 832(b)(1), "gross income" includes the gross amount earned from "underwriting income," which is defined in Section 832(b)(3) to mean "the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred." The term "expenses incurred" is specifically defined in Section 832(b)(6).[2] Pet. App. 18a-19a.

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.), as in effect for the tax years in issue, 1968-1970.

[2] Section 832(b)(6) provides in part: "The term 'expenses incurred' means all expenses shown on the annual statement

In accordance with these statutory provisions, petitioner included on its federal income tax returns as gross income only those premiums earned during the taxable year. It did not include the deferred premium installments.[3] Petitioner nevertheless deducted as current expenses the total amount of commissions to be earned by its agents on the policies sold by them, as shown on the NAIC statement. The effect of that procedure was to take a current deduction for unpaid expenses associated with a deferred or unearned premium, even though the premium itself was not to be taken into income until earned in a subsequent year. Pet. App. 4a, 16a-17a.

2. On audit, the Commissioner disallowed the deductions claimed for unpaid commissions on deferred premiums, reasoning that those deductions did not meet the "all events" test for accrual and did not result in a clear reflection of income. Petitioner sought redetermination of the resulting deficiencies in the Tax Court, which ruled in favor of the Commissioner

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approved by the National Association of Insurance Commissioners, and shall be computed as follows: * * *. For the purpose of computing the taxable income subject to the tax imposed by section 831, there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c)." Section 832(c) in turn provides: "In computing the taxable income of an insurance company subject to the tax imposed by section 831, there shall be allowed as deductions: (1) all ordinary and necessary expenses incurred, as provided in section 162 (relating to trade or business expenses) * * *."

[3] Thus, even though petitioner included deferred premium installments in its "premiums written" account on its books, those installments were not reported as income for federal income tax purposes because they were not "premiums earned * * * during the taxable year" under Section 832(b)(3).

(Pet. App. 13a-29a). Relying principally upon its earlier decision on the same issue in *Western Casualty & Surety Co.* v. *Commissioner*, 65 T.C. 897 (1976), aff'd, 571 F.2d 514 (10th Cir. 1978), the Tax Court disagreed with petitioner's contention that Section 832(b)(6) of the Code provides that the timing of a deduction for commission expenses is controlled by the time when the expenses appear on the NAIC annual statement using the NAIC Statutory Method. Rather, the court held that the application of the NAIC Statutory Method to permit the current deduction of unpaid commissions, when at the same time the associated unearned premiums are excluded from gross income, would not result in a clear reflection of income and would permit a deduction not allowable under either a cash or an accrual method of tax accounting. Pet. App. 22a-24a. Noting that the definition in Section 832(b)(6) expressly refers to expenses incurred, as provided in Section 162 of the Code (ordinary and necessary business expenses), the court ruled that "petitioner must meet the timing requirements on this deduction in the same manner as any other taxpayer under an accrual method of tax accounting" (Pet. App. 24a). See also *Western Casualty & Surety Co.* v. *Commissioner*, 65 T.C. at 905.

3. The court of appeals affirmed (Pet. App. 1a-12a). Stating its agreement with the Tenth Circuit's conclusion in *Western Casualty* that "the [NAIC] Statutory Method * * * is not absolute," the court explained that Congress intended that the Statutory Method be used only as the "starting point" for tax accounting, which may differ from the accounting used for bookkeeping or other purposes (see Pet. App. 10a). The court further noted that the Commissioner has the authority to reject a taxpayer's

accounting methods if they do not clearly reflect its income and that in this case petitioner "concedes that its tax accounting method does not clearly reflect income and expense" (*id.* at 11a). And the court rejected petitioner's contention that the Commissioner's refusal to follow petitioner's accounting method is prohibited by statute, explaining that Section 832 "is ambiguous with respect to application of the Statutory Method here and thus does not 'specifically authorize' its use for all tax accounting purposes" (Pet. App. 11a n.8).

ARGUMENT

The court of appeals correctly upheld the Commissioner's determination that petitioner cannot deduct from gross income agents' commissions payable only from deferred premiums not includible in gross income. The decision accords with *Western Casualty & Surety Co.* v. *Commissioner*, 571 F.2d 514 (10th Cir. 1978), the only other court of appeals decision to address the question, and it does not conflict with any decision of this Court. Thus, there clearly is no basis for review by this Court.

Indeed, petitioner explicitly disavows any intent to seek review of "[t]he underlying statutory issue below" (Pet. 2), *i.e.*, of the correctness of the judgment below that the Tax Court correctly upheld the Commissioner's asserted deficiencies. Instead, petitioner contends that this Court should grant review in order to remand the case for further proceedings because the court of appeals allegedly disposed of the case without responding to petitioner's argument that affirmance of the Tax Court's decision would make a "dead letter" of Section 832(b)(6). See Pet. i, 2, 10 & n.9, 14 & n.14. This contention provides no ground for review by this Court.

1. Rule 10 of the Rules of this Court provides that the certiorari jurisdiction will be exercised to review "decisions" or "judgments," but it does not indicate that it is appropriate for that jurisdiction to be invoked merely to review *opinions*. Petitioner's argument that this Court should grant certiorari and remand this case because of a perceived inadequacy in the court of appeals' *opinion*—without considering whether the *judgment* below is correct—is sharply at odds with the thrust of Rule 10. Moreover, since it is well established that this Court's exercise of jurisdiction is primarily responsive to the importance of the legal issues presented, not a mere desire to correct erroneous lower court decisions (see, *e.g.*, R. Stern, E. Gressman, & S. Shapiro, *Supreme Court Practice* 221-222 (6th ed. 1986); *Ross* v. *Moffitt*, 417 U.S. 600, 616-617 (1974)), it follows a fortiori that this Court should not exercise its jurisdiction to require the revision of an allegedly inadequately drafted opinion. Indeed, petitioner's argument suggests that every affirmance without opinion by a court of appeals automatically would call for Supreme Court review. This Court has declined in the past to review the contention that a court of appeals commits error by issuing an unpublished opinion (see *Barnes* v. *United States*, cert. denied, 109 S. Ct. 3156 (1989)), and there is even less reason to consider petitioner's objection here to the court of appeals' alleged failure to discuss adequately one of petitioner's arguments. As this Court has recognized, "the courts of appeals should have wide latitude in their decisions of whether or how to write opinions" (*Taylor* v. *McKeithen*, 407 U.S. 191, 194 n.4 (1972)).

2. In any event, there is no merit to petitioner's contention that the decisions below make a "dead letter"

of Section 832(b)(6), nor is petitioner correct that its argument to that effect received no response from the court of appeals. As we have noted, Section 832 (a) of the Code provides that, in the case of an insurance company subject to tax under Section 831, "taxable income" means gross income as defined by subsection (b)(1), less the deductions *allowed by subsection (c)*. Subsection (b)(1) then sets forth the five items that are included in gross income, and the remaining paragraphs of subsection (b), including subsection (b)(6) on which petitioner relies, then consist of definitions of terms employed in the definition of gross income in subsection (b)(1) or in the definition of underwriting income in subsection (b)(3). Since the statute explicitly states that *deductions* from gross income are to be found in subsection (c), while subsection (b) deals with *income*, the definitions in subsections (b)(2) through (b)(6) appear designed to establish the limits of income items; they do not authorize deductions.

Thus, petitioner errs in claiming that Section 832(b)(6) authorizes it to deduct unpaid commissions associated with unearned premiums. If an item of income such as unearned and deferred premiums is *excluded* from gross income (as was the case here because of the operation of subsection (b)(3) (see pp. 3-4 & note 3, *supra*)), then the definitions applicable to items *included* in income are no longer relevant with respect to that excluded item. That was the Tax Court's conclusion in *Western Casualty*, which held, in accordance with the language of Section 832(a), that deductions are authorized by subsection (c), not by subsection (b)(6). That decision was approved by the Tenth Circuit on appeal (see 571 F.2d at 517-518) and by the court of appeals in this case. In so holding, these courts did not make

Section 832(b)(6) a "dead letter." With respect to any item included in gross income—and there are many other than deferred premiums—Section 832 (b)(6) operates to modify the amount of that item to the extent of "expenses incurred" in relation to that item.[4]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[4] The opinion of the court of appeals conforms to this analysis, even though the opinion does not in so many words state why Section 832(b)(6) is not a "dead letter." The opinion sets forth the relevant provisions of the statute and indicates the relationships of the several subsections and paragraphs (Pet. App. 6a-8a), acknowledges petitioner's contentions (including its "dead letter" argument (*id.* at 8a)), and states the Commissioner's responses (*id.* at 8a-10a). Ultimately, the court agrees with *Western Casualty* and *Gerling Int'l Ins. Co.* v. *Commissioner*, 839 F.2d 131, 134 & n.6 (3d Cir. 1988), that an insurance company may not deduct "expenses not yet actually paid or incurred" (Pet. App. 10a). And the court correctly states that the mismatching of income and deductions urged by petitioner is not "specifically authorized" by the statute, because Section 832(b)(6) does not make the Statutory Method conclusive for tax accounting purposes (Pet. App. 11a n.8).

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